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THE SURETY'S RIGHT TO INDEMNITY—EFFECT OF PRINCIPAL'S BANKRUPTCY

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As has often been remarked, it is seldom possible, in the study of our common law, to take things by categories. Suretyship gives a good example. Nothing in that branch of the law is better settled, nothing less apparently open to influences from without, than the rule of indemnity, as between principal and surety. The principal, so runs the rule, is bound to make good to the surety if the latter has been compelled to pay the debt; the only condition being that he must pay the whole debt instead of only part.¹ Such was the simple thought that was recognized by the law merchant and by equity² long before the courts of law, through their use of the common counts, came to hear of it. If ever a principle could be set off by itself and card-indexed as belonging to a specific department of the law, without cross-reference to any other, it would seem to be this.

But of equal step with the passage of this precept into its acceptance by the common-law courts came other rules which were destined to cross its path. Even in its simplest form of application the law of suretyship was not to stand alone. And so the idea, that the surety is entitled to reimbursement from his principal, has been intersected by doctrines which belong to entirely different divisions of our legal system. The result is that, properly to appraise the relation of principal and surety, we must take into account developments in the statutes of bankruptcy, in the law of judgments, and in the law concerning creditors' rights. As a general proposition it remains true that the surety can have the reimbursement to which natural justice entitles him; but not always is this so, and, to know the when and why of the matter, we must go as far afield as the subjects just mentioned, however remote they apparently may be.

Let us start with bankruptcy. That system, as we know it today, has two outstanding features, the administration of the debtor's estate, and his discharge.

Under the law of today, there are two methods of obtaining a dis-

¹ See 1 Brandt, *Suretyship* (3d ed. 1905) sec. 338; *McGrath v. Carnegie Trust Co.* (1917) 221 N. Y. 92, 116 N. E. 787; *Pa. Society, etc. v. Philadelphia Co.* (1920, C. C. A. 3d) 266 Fed. 1, 5.

² "By the custom of the city of London" the surety was entitled to such relief. *Layer v. Nelson* (1687, Ch.) 1 Vern. 456. As to the enforcement of this right in equity, see Ames, *Lectures on Legal History* (1913) 149, 155-6.

charge. Originally, as provided by the statute of Anne³ and by our first national Act of 1800, the court could not grant a discharge unless the bankrupt presented a favorable certificate, signed by a certain proportion of his creditors. The present statutes of both England and this country dispense with the certificate, and require a discharge unless the bankrupt has committed specified offences⁴; but the effect is the same; the bankrupt, if he gets his discharge, departs but leaves his estate in judicial custody. The other method of discharge is afforded by the composition in bankruptcy, by which the bankrupt offers to bring into court assets in place of those belonging to his estate. His tender not only must be accepted by a majority of the creditors, but must receive the court's approval. This will be withheld unless the proposition is more attractive than the alternative of liquidating the estate on hand;⁵ but, if the court approves the scheme, the bankrupt stands discharged.⁶ And thus, by either method of discharge, the debtor leaves behind him something which his creditors may have, but goes free of all debts entitled to share in the distribution of the estate left in the hands of the court; the proviso which our present statute (sec. 17) makes in favor of certain claims, as being provable but not barred by discharge, being immaterial to this discussion.

Of the two prominent features of bankruptcy, the debtor's discharge was the more complete innovation. There was nothing new in the idea of administration, because equity had developed a liquidating jurisdiction of its own. This jurisdiction, indeed, which originated with the estates of decedents, is still of force, in its original form, in England and in some of our states; and, in this country, it has been extended so as to include insolvent corporations and limited partnerships.⁷ But the discharge of the debtor without the consent *in pais* of the creditor was a very different thing. It could not be effected by equity, because the chancery ideas of liquidation were concerned only

³ Statutes (1705) 4 Anne, c. 17, sec. 19; (1706) 5 Anne, c. 22; (1718) 5 Geo. I, c. 24, sec. 16; (1732) 5 Geo. II, c. 30, sec. 10; (1825) 6 Geo. IV, c. 16, secs. 131, 122.

⁴ National Bankrupt Act 1898, Act of July 1 (30 Stat. at L. 544, 550) sec. 14 b; English Bankrupt Act 1914, 4 & 5 Geo. V, c. 59, sec. 27. As Hough, J., has remarked, a debtor comes out better with an absolute right to a discharge, in the absence of proof of offence, than he did in the days when his discharge was primarily dependent on a vote of the creditors. *In re Kaufman* (1917, C. C. A. 2d) 239 Fed. 305, 306.

⁵ See *In re Wayne Realty Co.* (1921, N. D. Ohio) 275 Fed. 955.

⁶ English Bankrupt Act 1914, sec. 28; Nat. Bankr. Act 1898, sec. 14 c; *Cumberland Glass Co. v. DeWitt* (1915) 237 U. S. 447, 35 Sup. Ct. 636; *In re American Paper Co.* (1919, D. N. J.) 255 Fed. 121; *Ex parte Jacobs* (1875) L. R. 10 Ch. App. 211. The same thing is provided by many state laws, e. g., New York Debtor & Creditor Law, sec. 230; *Matter of Samra* (1915) 169 App. Div. 604, 155 N. Y. Supp. 411.

⁷ Glenn, *Creditors' Rights* (1915) ch. 16.

with the fund in the hands of the liquidator. It could be done by an informal composition, but that operated as a matter of contract as distinct from law, and the discharge of the debtor, therefore, was a thing of release rather than of statute.⁸ But, so far is it from the conception of lawyers and judges that a living debtor could be discharged in a liquidation without a composition to which all the creditors should assent, that a general assignment was considered as void, as against any objecting creditor, if it required him to release the debtor as a condition of participating in the distribution.⁹ It is, therefore, no matter of wonder that early bankruptcy legislation did not provide for the discharge of the debtor. That, indeed, was the state of things up to the beginning of the eighteenth century. The debtor's discharge was not an integral feature of bankruptcy as it was conceived in the basic statute of Elizabeth; nor was anything of the sort added by amendment until the time of Queen Anne. As a natural consequence, the bankrupt's discharge has not the slightest effect on the estate in the hands of the court, or on the right of his creditors to share in it.¹⁰

The discharge, once obtained under such a statute, has two aspects, interesting in their diversity and yet consistent. From one point of view it operates, as one might so put it, as matter of law; in quite as important, if a different, direction, it has no such effect.

First of all, whether it be obtained through statutory composition or the older form of procedure, it does not result from any voluntary act of the creditor. And in this it differs from the informal compositions in which bankruptcies so often had terminated prior to the composition being made a part of the procedure in the court itself. In the instance of an informal composition the debtor's escape came from the unanimous act of his creditors in releasing his debts by deed *in pais*. But the statutory discharge through composition receives its sanction from the law, and not from the creditors. Their vote sets the law in motion; but it is the statute which discharges the bankrupt of his debts, and not their act.¹¹

Nevertheless, the statutory nature of the discharge is not reflected in its operation. That bankruptcy proceedings are *in rem* is true only as concerns the administration of the estate.¹² A discharge is quite a dif-

⁸ *Phelps v. Borland* (1886) 103 N. Y. 406, 9 N. E. 307; *Browne v. Carr* (1831, C. P.) 7 Bing. 508.

⁹ *Grover v. Wakeman* (1834, N. Y.) 11 Wend. 187.

¹⁰ This is true whether he is discharged in the old way [*In re Lighthall* (1915, N. D. N. Y.) 221 Fed. 791] or through composition. *United States v. Sondheim* (1910, D. Mass.) 188 Fed. 378; *In re Cadenas* (1910, S. D. N. Y.) 178 Fed. 158.

¹¹ *Browne v. Carr*, *supra* note 8.

¹² In the older cases, it is true, we find language like this: "But the proceedings were so far *in rem* that actual notice to the creditors is not essential to the jurisdiction of the court; nor will the want of it invalidate the discharge." *Rayl v. Lapham* (1875) 27 Ohio St. 452, 458. But recent decisions have clearly estab-

ferent thing. It is a personal defence, and must be pleaded to be available.¹³ If not seasonably pleaded, it cannot later be used to invalidate the adverse judgment entailed by this neglect; for the principle of *res judicata* is of higher value than any concept that can be afforded by a release, even though it should flow from a statute rather than the seal of the creditor. That is why the bankruptcy court is not interested in the debtor after his discharge.¹⁴ Indeed, while it is true that the court, during the pendency of the bankruptcy proceedings, can protect the debtor from suits against him, and from arrest on civil process on provable debts, yet the sole purpose even of this is to protect the estate, and therefore judicial action in that behalf is wholly discretionary.¹⁵

If, then, the principal is discharged in bankruptcy, this does not destroy the debt which the surety has underwritten, and hence the surety's liability should continue. In this the courts agreed even before statutes came expressly to provide to that end.¹⁶ A bankruptcy discharge does not destroy the debt; it only gives the bankrupt the benefit of a plea in bar, but a plea which does not deny the continued existence

lished that language used about bankruptcy proceedings being *in rem* must be confined to decrees and orders affecting the distribution of the assets. "The adjudication is, for the purpose of administering the debtors' property, that is, in its legislative effect, conclusive upon all the world," but in no other respect is this true. *Gratiot Bank v. Johnson* (1919) 249 U. S. 246, 39 Sup. Ct. 263; *Pell v. McCabe* (1919) 250 U. S. 573, 40 Sup. Ct. 43. See also NOTES (1919) 19 COL. L. REV. 313.

¹³ *Moyer v. Dewey* (1880) 103 U. S. 301; *Friend v. Talcott* (1913) 228 U. S. 27, 33 Sup. Ct. 505. Upon this rests the doctrine which allows the so-called "revival" of a debt against which the debtor has been discharged in bankruptcy. The new promise does not revive the debt; it simply waives the personal defence of the discharge; and hence the creditor should declare on the old debt, reserving the new promise to establish by way of replication to the anticipated plea of the discharge. *Moyer v. Dewey*, *supra*. A discharge in composition has exactly the same effect; and hence the new promise can revive a debt barred by that sort of discharge. *Zavelo v. Reeves* (1913) 227 U. S. 625, 33 Sup. Ct. 365; *Herrington v. Davitt* (1917) 220 N. Y. 162, 115 N. E. 476.

¹⁴ See *Dimock v. Copper Co.* (1886) 117 U. S. 559, 6 Sup. Ct. 855.

¹⁵ See Bankrupt Act, sec. 9 (30 Stat. at L. 544, 549); *Ex parte Harrison* (1921, D. Mass.) 272 Fed. 543; *In re Federal Biscuit Co.* (1913, C. C. A. 2d) 210 Fed. 37, (1914, C. C. A. 2d) 214 Fed. 221; *In re Maaget* (1909, S. D. N. Y.) 173 Fed. 232; *In re Weisberg* (1918, E. D. Mich.) 253 Fed. 833; *Peck v. Jenness* (1849, U. S.) 7 How. 612.

¹⁶ See *Thayer v. Daniels* (1872) 110 Mass. 345; *Mason v. Bancroft* (1876, N. Y.) 1 Abb. N. C. 415. The present bankrupt acts of both England and this country expressly so provide, whether the discharge be effected by composition or otherwise. Nat. Bankr. Act 1898, secs. 12, 16 (30 Stat. at L. 544, 550); English Bankrupt Act 1914, secs. 28, 16. The same proposition applies to compositions under the Bankrupt Act; the surety not being discharged. *In re American Paper Co.* (1919, D. N. J.) 255 Fed. 121; *Easton Co. v. Caminez* (1911) 146 App. Div. 436, 131 N. Y. Supp. 157; *Guild v. Butler* (1877) 122 Mass. 498; *Cilley v. Colby* (1881) 61 N. H. 63. As to state laws, see *supra* note 6.

of the debt; hence the very wording of the plea, when made by the principal, excludes repetition by the surety. The distinction is best shown, it is believed, by the difference between the case where a bankruptcy has terminated through an informal composition in which all the creditors join, and the case of a statutory composition in the course of the bankruptcy. In the first case the composition constitutes a defence for the surety as well as his principal, because each creditor has actually released his claim to the debtor¹⁷; but in the other case the creditors have released nothing.¹⁸ Such, then, is the first intersection of bankruptcy law with our rule of suretyship.

Not far beyond this crossing we meet another doctrine. This one has nothing in common with bankruptcy, and is more fundamental because it starts from no statutory source. If the discharge of the debtor in bankruptcy is not available to the surety, how may the creditor be secured in his enjoyment of the proposition? If the surety's agreement has taken the form of a guaranty, whether it be of collection or of payment, the situation is easy, because the creditor, by virtue of the contract, goes against the surety only for what he has failed to get out of the debtor; and therefore the debtor's discharge gives the creditor recourse against the guarantor on the separate contract thus constituted.¹⁹ But if the surety has bound himself to the creditor jointly with the principal, the latter's discharge presents a problem. Common-law courts were bound to respect the bankrupt's discharge, for it was an act of the law which governed them in their doings. And so, although the court of bankruptcy had no power to stay suits pending against the bankrupt after the discharge was obtained,²⁰ it was the duty of common-law courts to admit the discharge by way of plea in bar, or, if the suit meanwhile had gone to judgment, perpetually to stay the issuance of execution.²¹ But this sort of thing complicated matters in

¹⁷ *Phelps v. Borland*, *supra* note 8; *Cargoe v. Jones* (1873) L. R. 8 Exch. 81; *Webb v. Hewitt* (1857, Ch.) 3 Kay & Johns. 438. To same effect if creditor, by agreement with bankruptcy trustee, binds himself not to prove against the estate of principal. *Re Wolmershausen* (1890, Ch.) 62 L. T. R. 541.

¹⁸ Cases cited *supra* note 6.

¹⁹ This under the most exacting rule. *Craig v. Parkis* (1869) 40 N. Y. 181. For the more moderate rule see *Brckett v. Rich* (1877) 23 Minn. 485, and cases there cited.

²⁰ *Hellman v. Goldstone* (1908, C. C. A. 3d) 161 Fed. 913; *In re Lockwood* (1917, E. D. N. Y.) 240 Fed. 161; *In re Rosenthal* (1901, S. D. N. Y.) 108 Fed. 368; *In re Weisberg*, *supra* note 15.

²¹ Refusal of a state court so to do is reversible error cognizable in the Supreme Court, the case involving rights conferred by a federal statute. *Hill v. Harding* (1883) 107 U. S. 631, 2 Sup. Ct. 404; *Boynton v. Ball* (1887) 121 U. S. 457, 7 Sup. Ct. 981. Beyond granting a perpetual stay, however, a state court cannot go in the absence of laws of its own jurisdiction; but many states have statutes requiring the cancellation of such judgments. See *Walker v. Muir* (1909) 194 N. Y. 420, 87 N. E. 680; *Rukeyser v. Tostevin* (1919) 188 App. Div. 629, 177 N. Y.

the case of a joint obligation. The principal's discharge would, strictly speaking, bar the entry of judgment against him; but, if no judgment could go against him, neither could it go against the surety, and thus against the latter the creditor would be deprived of recourse despite the fact that the principal's discharge did not release the surety. This would have presented a case for equity had not the courts discovered that they possessed a certain flexibility in the enforcement of their judgments, however automatic their course was up to the moment of judgment. Their discovery had been demonstrated in suits against an executor; if his plea of *plene administravit* prevailed, the judgment was "of assets *quando acciderint*." To other cases also had the courts applied their latent capacity to do justice²² and, therefore, when the question arose of which we have taken note, the common-law courts in most jurisdictions found that they could handle the matter without remission to equity. What they did was to enter judgment against both parties, but immediately to stay execution against the principal.²³ Thus the creditor got his due, with no detriment to the principal's rights under his bankruptcy discharge.

The entry of any such judgment naturally makes the surety consider the means he may use to get reimbursed. It of course may happen that

Supp. 291; *Hershman v. The Justices* (1915) 220 Mass. 137, 107 N. E. 543; *Barry v. N. Y. Holding Co.* (1918) 229 Mass. 308, 118 N. E. 639.

²² "But the common law adjudications show that the judgment may be moulded so as to conform to the rights of the parties under the law, and by analogy support the view we take. Thus, in *Peck v. Jenness*, 7 How. 612, where the plaintiff attached goods of his debtor before the latter was proceeded against in bankruptcy, and where, pending the action, the debtor was discharged, the supreme court of the United States held that it was competent and proper for the court to render a judgment, notwithstanding the discharge, for the amount of the debt, damages, and costs, 'to be levied only of the goods of the defendant attached on plaintiff's writ, and not otherwise.' 'The books,' says Mr. Justice Grier, in this case, 'are full of precedents for such judgment. When an administrator pleads *plene administravit*, the plaintiff may admit the plea, and take judgment of assets, *quando acciderint*. When the defendant pleads a discharge of his person under an insolvent law, the plaintiff may confess the plea, and have judgment, to be levied only of defendant's future effects.' (7 How. 623.) So, subsequently, the supreme court held that when contracts made payable in coin are sued upon, judgments may be entered for coined dollars, and parts of dollars (*Bronson v. Rodes*, 7 Wall. 229). Upon the whole, our judgment is that the action is well brought against the county; that the county may make defense, but, if the plaintiff shall be found entitled to recover, he may have judgment against the county for his debts, damages and costs to be enforced, if necessary, by *mandamus* against the county court, or the judges thereof, to compel them to levy and collect a special tax according to the statute in such case provided, and not otherwise." Dillon, J., in *Jordon v. Cass County* (1874, C. C. W. D. Mo.) 3 Dill. 185, 194: approved in *County of Cass v. Johnston* (1877) 95 U. S. 360, 370; see also *Fuller v. Aylesworth* (1896, C. C. A. 6th) 75 Fed. 694.

²³ *Hill v. Harding* (1889) 130 U. S. 699, 9 Sup. Ct. 725; *Wolf v. Stix* (1878) 99 U. S. 1; *U. S. Engine Co. v. North Penn. Iron Co.* (1910) 227 Pa. 262, 75 Atl.

he has been forehanded enough to take security from his principal as a condition of going surety at the outset; in that event, provided the security is adequate, the surety need not be disturbed by the principal's bankruptcy. The court which is administering the estate cannot deprive the surety of his collateral, so long as there is a chance that he may be called upon to pay the creditor. If the nature of the obligation assumed is such that the principal's bankruptcy—not his discharge, but his bankruptcy, and of this more will be said hereafter—terminates the surety's liability, naturally he must hand over the collateral to the principal's estate; but in all other cases he may retain it, being accountable to the estate only for the surplus value of it.²⁴ But in the more usual case the surety has no collateral; and this, too, even in the present day, when suretyship for hire has so largely displaced the original idea of the surety being an accommodating friend as to give rise to an exception to the older view of the law regarding the surety's situation.²⁵ Having no security, where can the surety go for reimbursement after he has paid the creditor?

His first thought naturally would be of recourse upon the principal. But the latter's discharge protects him, with a few exceptions not necessary here to note, against all claims that may be proven against the estate which he has left behind him in the bankruptcy court; and this turns the surety to the inquiry whether he can prove against his principal's estate. What sort of claim can he prove? Bankruptcy statutes provide a time limit for the proof of claims, a limit which is rigidly enforced²⁶; and so it is important for the surety to know whether his claim against the principal's estate can arise prior to his actually paying the creditor, as perchance the latter may be dilatory in pressing for his

1094; *In re Mercedes Import Co.* (1908, C. C. A. 2d) 166 Fed. 427; *Butterick Pub. Co. v. Bowen Co.* (1911) 33 R. I. 40, 80 Atl. 277; *Schunack v. Art Metal Co.* (1911) 84 Conn. 331, 80 Atl. 290.

²⁴ *In re Federal Biscuit Co.* (1914, C. C. A. 2d) 214 Fed. 221; *In re Mercedes Import Co.*, *supra* note 23; *In re O'Donnell* (1904, D. Mass.) 131 Fed. 150. In *Farming Co. v. Brannon* (1920, C. C. A. 6th) 263 Fed. 891, the court held that a surety, secured by indemnity which consisted of a bond and mortgage given by the debtor, cannot prove on the bond, but is limited to proving on the debt as paid by him. This, however, involves nothing peculiar to suretyship law.

²⁵ "It is urged that the rule of strict construction generally applicable to the obligation of sureties should be here applied. But this is not that ordinary contract of voluntary suretyship, as to which there has arisen a sort of tenderness towards sureties. This is a contract of insurance, entered into by the surety for the revenue which it derives from the business of suretyship, and in this relation the obligation should be treated as other insurance contracts, which are usually construed most strongly against the insurer." *National Surety Co. v. McCormick* (1920, C. C. A. 7th) 268 Fed. 185, 188; *Guaranty Co. v. Pressed Brick Co.* (1903) 191 U. S. 416, 24 Sup. Ct. 142; *St. Johns College v. Aetna Co.* (1911) 201 N. Y. 335, 342, 94 N. E. 994, 996.

²⁶ See cases cited *infra* note 33.

money. This, being a practical problem, went to the courts for solution; and, although we find the Supreme Court on one occasion declining its aid in this regard,²⁷ eventually a rule was evolved which now governs us. Before stating that rule let us consider its origin.

A claim cannot be proven as of a certain date unless it is of the class which the statute contemplates as fitted to share in the assets of the estate. And, in determining the nature of a claim in this regard, the original test was whether it had so matured that assumpsit would have lain if the bankruptcy had not occurred. English legislation of modern times has destroyed this test by its broad inclusion of contingent claims. Our national legislation, on the contrary, has been fitful. The bankruptcy acts of 1841 and of 1867 allowed the proof of contingent claims; but our present law does not; the most that it does is to make the bankruptcy accelerate certain kinds of claims.²⁸

Under such a statute as we now have, let us take the case of matured claims. It is obvious that, in advance of paying the creditor, the surety has no right to prove in the bankruptcy; for he can bring assumpsit only for reimbursement, not protection.²⁹ In order to prove a claim against the estate, therefore, the surety must pay the creditor within the time limit allowed for claims; and this even though he must hunt up the creditor for that purpose. But pursuing a creditor in order to pay him is an idea more sternly just than it is alluring, and the surety may prefer not to do so. In that event he is barred from sharing in his principal's estate. But, if later the creditor should become active enough to extort payment from the surety, can the latter then hold the principal despite the discharge? Undoubtedly, if we are to consider only the fact that the creditor has not been paid, because that leaves the surety without a provable claim in the principal's bankruptcy, and so leaves him with a claim against which the principal's discharge constitutes no bar. There is no inherent vice in this reasoning, and the courts which have yielded to it³⁰ have much in their favor. But never-

²⁷ "If the sureties should ultimately pay the amount of any such judgment, and thereby acquire a claim to be reimbursed by their principal the amount so paid (which is a point not now in issue), it would be because his liability to them upon such a claim did not exist at the time of the commencement of the proceedings in bankruptcy, and therefore could not be proved in bankruptcy nor barred by the discharge, and consequently would not be affected by any provision of the Bankrupt Act." *Hill v. Harding* (1889) 130 U. S. 699, 704, 9 Sup. Ct. 725, 726.

²⁸ See 3 Williston, *Contracts* (1920) sec. 1982, *et seq.*

²⁹ *In re Astoraga Paper Co.* (1916, N. D. N. Y.) 234 Fed. 792; *Loeser v. Alexander* (1910, C. C. A. 6th) 176 Fed. 265. "A surety or an indorser for the bankrupt, whose liability is contingent, cannot prove a claim of his own by reason of such liability. It is only the creditor's claim which is provable." *In re Astoraga Paper Co.*, *supra* at p. 795.

³⁰ *Thayer v. Daniels* (1872) 110 Mass. 345; *Sibley v. McAllister* (1836) 8 N. H. 389.

theless those courts overlooked something. The proposition, that it is not the debtor's duty to pursue his creditor with the money that is due, has no affirmative aspects; and the debtor can never derive from it any sort of collateral advantage.³¹ It is not difficult to apply this thought to the instant problem. The surety should pay the debt, and then prove his claim. If the debt is in dispute, the surety can protect himself by vouching in the trustee in bankruptcy; if then there is an adverse judgment, the trustee cannot dispute its validity³²; and meanwhile, it is believed, the bankruptcy court would receive a proof of claim by the surety although it necessarily is expressed to be contingent on the event of the suit.³³ Furthermore, the surety always has had it at his option to compel the creditor to prove his claim against the principal's estate, so as to get, as contingent credits against his own account, the dividends which the creditor would thus receive.³⁴ Putting these things together, the surety ought not to be allowed to hold the principal after the latter's discharge. And to this conclusion the Supreme Court has finally come, although not, it must be confessed, upon very satisfactory reasoning.³⁵

³¹ Thus the debtor cannot complain if the creditor fails to foreclose a mortgage promptly when due, even if his delay causes depreciation in the value of the collateral. *Lewis v. Blume* (1917) 226 Mass. 505, 116 N. E. 271.

³² See *Severson v. Macomber* (1914) 212 N. Y. 274, 106 N. E. 72; *Hare v. Grant* (1877) 77 N. C. 203.

³³ See *In re Lyons Sugar Co.* (1911, W. D. N. Y.) 192 Fed. 445. This would seem to follow from the principle established in such cases as *In re Sampter* (1909, C. C. A. 2d) 170 Fed. 938; *In re Baker Notion Co.* (1910, S. D. N. Y.) 180 Fed. 922 (secured creditor can and must file temporary proof pending the liquidation of his claim by foreclosure of the lien); *Page v. Rogers* (1909) 211 U. S. 575, 29 Sup. Ct. 159; *Keppel v. Tiffin Bank* (1905) 197 U. S. 356, 25 Sup. Ct. 443 (creditor with unlawful preference may prove claim after final judgment setting aside the preferential transfer).

³⁴ This is "settled law," to use the words of both Lord Eldon [*Ex parte Rushforth* (1805, Ch.) 10 Ves. 409] and Chancellor Kent, *Hayes v. Ward* (1819, N. Y.) 4 Johns. Ch. 123. "It is now settled that a surety may require the creditor, upon a proper indemnity, to go and prove his bond under a commission of bankruptcy of the principal debtor; and the creditor will be a trustee for the dividends to the surety paying the whole." *Hayes v. Ward*, *supra* at p. 132, and cases there cited. This balances the proposition that, while the surety could not prove unless he paid off the whole debt, yet the creditor, while entitled to prove for the whole without crediting part payments by the surety [*Re Souther* (1874, D. Mass.) 2 Low. 320], held any surplus thus realized in trust for the surety. *In re Baxter* (1878) 18 Nat. Bankr. Reg. 497.

³⁵ *Williams v. U. S. Fid. etc. Co.* (1915) 236 U. S. 549, 35 Sup. Ct. 289. The court cited *Mace v. Wells* (1849, U. S.) 7 How. 272; accord, *Tobias v. Rogers* (1855) 13 N. Y. 59. Those cases were decided under the Act of 1841, which allowed proof of contingent claims. As the surety, under such a statute, could prove against the principal's estate without paying the creditor, naturally the principal's discharge barred any claim for reimbursement. Such cases have no bearing under our present Act, which allows no such proof by the surety.

What about a claim that has not matured? It certainly is not the duty of any kind of debtor to pay before the debt becomes due. It has been held, however, that a surety, if he pays a debt before it is due, is entitled to reimbursement at the due date provided he can show that nothing meanwhile could have happened that would have relieved both the principal and himself from the obligation of paying at all.³⁶ That is logical enough, when the principal is master of his own affairs. But when he goes into bankruptcy his creditors share in a limited fund, and it is of importance to each creditor that no one else be allowed to prove for more than is justly due. It follows that no surety can acquire for himself a provable claim by paying an unmatured debt unless the bankruptcy itself accelerates the maturity. That happens with certain sorts of claims³⁷; and in any such case the surety's position is just as it would be with a claim that had matured prior to the bankruptcy. But in no other case should the surety be allowed to pay and then prove; the rights of the real creditors to an undisturbed distribution of the bankrupt's estate, dedicated to that purpose by the bankruptcy, forbid the very thought of such a thing. The surety and his principal should be left where they were, to handle the claim when it should mature, just as if there had been no bankruptcy, and no discharge. The debt not being provable, the principal cannot plead his discharge against it; and, by the same token, the discharge would not be available against the surety in case he should be compelled to pay in the first instance.³⁸

So much for the ordinary bearings of bankruptcy upon the surety's right of reimbursement. All the results traced in the preceding paragraphs have flowed from one central idea, that bankruptcy never destroys a debt. The bankrupt is discharged from his provable debts, but the discharge is merely a personal defence, which he can waive if he so pleases; and his waiver, in the given instance, leaves the old debt

³⁶ *Guckenheimer v. Kahn* (1914) 243 Pa. 75, 89 Atl. 807; *Hotham v. Berry* (1910) 82 Kan. 412, 108 Pac. 801; *contra*, *Ladd v. Chamber of Commerce* (1900) 37 Or. 49, 60 Pac. 713, 62 Pac. 208.

³⁷ See authorities cited *supra* note 28; also *Central Trust Co. v. Chi. Auditorium* (1916) 240 U. S. 581, 36 Sup. Ct. 412, establishing the rule that bankruptcy operates as an anticipatory breach of contract. Of course, the doctrine of anticipatory breach does not apply to every sort of contract. See Glenn, *Proof of Unmatured Claims in Bankruptcy* (1910) 10 COL. L. REV. 709, *et seq.*

³⁸ See *Moch v. Market St. Bank* (1901, C. C. A. 3d) 107 Fed. 897; *Leader v. Mattingly* (1904) 140 Ala. 444, 37 So. 270. *In re Baker* (1915, E. D. N. C.) 224 Fed. 611, where a surety on a lease which had several years to run was allowed to prove for rent not yet accrued, is undoubtedly wrong, because the rent was not accelerated by the bankruptcy. See *supra* note 37. This conclusion is by no means affected by the rule which so construes the statute as to allow the surety who has paid the debt to prove, although the debt became due after the filing of the petition, provided proof is made within the time limit set by the statute. *Moch v. Market St. Bank*, *supra*; *In re Semmer Glass Co.* (1905, C. C. A. 2d) 135 Fed. 77.

in full force and vigor. Bankruptcy simply plays upon the enforceability of obligations, but none of them does it cancel. Nor can this result be obviated by contract. A stipulation that a debt shall not be proven in bankruptcy is of the same class as a provision that no suit shall be brought on a contract. If given its proper weight such a stipulation simply means that there is no intention to create a debt; the beneficiary is no creditor, as we know that term.³⁹

But it is not necessarily the same with the surety's obligation. In one sense his contract follows that which the principal makes; in general, he must answer for the principal's breach. But the surety's obligation need not be as broad as that of his principal; and it is conceivable that one may undertake to respond for another's default only to a certain degree. It is quite possible, therefore, to conceive of a principal going into bankruptcy without the surety becoming liable, because of the way in which the surety has framed his undertaking. And there are such cases in reality,—two classes of them, in fact.

In the first place there is the well-known rule of adoption. A bankruptcy trustee can, if he so elects, adopt an outstanding contract of the bankrupt. If he does so the bankrupt is relieved from further liability, and the contract becomes one with the trustee.⁴⁰ In that event it would seem clear that the surety is relieved from further responsibility. He bound himself for his principal's performance, not for that of a substitute; and hence the substitution of the trustee for the principal simply ends the matter so far as the surety is concerned.

In that sort of case the discharge of the surety flows, not from the adjudication in and of itself, but from the subsequent act of the trustee in adopting the contract which the surety had underwritten. But there is another class of cases where the bankruptcy, if it is to have any effect upon the surety's obligation, operates of its own force without the aid of ensuing acts on the part of anybody. This situation is presented by certain kinds of "court bonds"—the ones in question being *supersedeas* bonds, and bonds to relieve attachments. And once more we are led into fields of the law which lie outside of suretyship.

The *supersedeas* bond is given where the defendant in an action desires, not only to appeal from the judgment in which he has been cast, but also to stay the issuance of execution pending the decision of the appeal. The condition of such a bond therefore is the prosecution of the appeal to effect, and the payment of the judgment in case it is affirmed. The bond to relieve an attachment is a little more complicated. Originally its primary object was to compel the appearance of

³⁹ See *Burt v. Rattle* (1876) 31 Ohio St. 116; *Cass v. Realty Co.* (1911) 148 App. Div. 96, 132 N. Y. Supp. 1074, aff'd. (1912) 206 N. Y. 649, 99 N. E. 1105; *In re Fechheimer* (1914, C. C. A. 2d) 212 Fed. 357.

⁴⁰ *Dayton Co. v. Felsemthal* (1902, C. C. A. 6th) 116 Fed. 961; *In re Wiseman* (1908, E. D. Pa.) 159 Fed. 236; *Hanna v. Iron Co.* (1918) 222 N. Y. 290, 118 N. E. 629.

the defendant in the action, and therefore no defence could be put in unless the bond was given; such was the custom of London, and such is still the rule in a few of our states.⁴¹ But modern statutes seek for more than that. Their object is not so much to compel an appearance as to give the plaintiff security for such judgment as he may finally obtain in the action⁴² and consequently the giving of a bond is not necessary to the defence of the suit if the defendant chooses to leave the property under the attachment writ.⁴³ There is also, among the states, a difference in the tenor of the bonds sanctioned; the difference lying in whether the bond takes the place of the attachment lien or is a substitute merely for the property attached. In both cases the extent of the obligation is the same: it represents the value of the property attached. The bond to discharge an attachment runs directly to the plaintiff and binds the payment of the judgment *pro tanto*; but the other sort of bond, the "forthcoming bond," has as obligee the officer who has executed the writ, and requires payment to him in case the plaintiff recovers in his suit. Theoretically speaking, in the first case

⁴¹ "By the custom (of London, the source of the attachment) a defendant could not appear or raise an issue about the debt claimed without entering special bail, or else surrendering his body." *Owmbey v. Morgan* (1921) 41 Sup. Ct. 433. James, L. J., says: "It is clear that foreign attachment is in its substance, origin, and intention a process to compel appearance. . . . If the debtor fails to appear he is considered to have admitted that the debt claimed was due to the extent of the money in the hands of the garnishee. If the debtor appears—but only in this event, and in case nothing is done in the meantime—and renders himself up, the process is at an end, and the plaintiff has no more claim upon the moneys attached." *Levy v. Lovell* (1880) L. R. 14 Ch. Div. 234, 238.

"Foreign attachment is but a process by which to commence a personal action. It seizes property to compel an appearance. It can be dissolved upon entering bail, and when dissolved, the judgment against the defendant is *in personam*." *Albany Ins. Co. v. Whitney* (1871) 70 Pa. 248, 252.

⁴² "The process of attachment, as it existed under the common law, differed in its nature and object from the provisional remedy now known by that name. Its original purpose was to acquire jurisdiction of the defendant by compelling him to appear in court through the seizure of his property, which he forfeited if he did not appear, or furnish sureties for his appearance. . . . It was part of the service of process in a civil action through a species of distress, in which the goods attached were the ancient *vadii* or pledges. . . . Its present purpose is not to compel appearance by the debtor, but to secure the debt or claim of the creditor. It is a proceeding *in rem*, and the process may issue, in certain cases, whether the defendant has been served with a summons or not, although inability to serve, through the fault of the defendant, is a ground upon which the warrant may be granted. It exists, as a provisional remedy, only when authorized by statute, and, as such, is comparatively recent in its origin. . . . It is not only created by statute, but has substantially none of the features peculiar to the common law remedy." *Penoyar v. Kelsey* (1896) 150 N. Y. 77, 79-80, 44 N. E. 788.

⁴³ *Pendente lite*, the statutes of Delaware, from whose courts *Owmbey v. Morgan*, *supra* note 41, went to the Supreme Court, were amended to that effect.

the bond is an entire substitute for the attachment, the latter disappearing from legal contemplation; while the forthcoming bond, on the contrary, has place only as subordinate to the attachment, which is still of force.⁴⁴ But no matter which sort of bond is required in the particular jurisdiction, at least one consequence is inevitable,—the property previously attached is no longer subject to the plaintiff's lien. It is the free property of the debtor, and if he becomes bankrupt, it constitutes part of his estate. In ultimate effect, therefore, any such bond, *supersedeas*, forthcoming, or in discharge of attachment, comes to this, that the surety on it is bound in form to respond either to the plaintiff, or to the levying officer for his use, in case judgment is recovered or affirmed as the case may be. Such a bond constitutes the plaintiff's only specific recourse. He may, of course, prove in the bankruptcy, but naturally he will be more interested in the bond. In any such case does the principal's bankruptcy afford the surety any defence?

The decisions are at variance. The English courts held that the principal's discharge in bankruptcy pending an appeal did not release the sureties on a *supersedeas* bond, and this decision was followed in New York.⁴⁵ In Georgia an opposite result was reached.⁴⁶ As to attachment bonds, there is likewise a difference of opinion. Under the Bankruptcy Act of 1867 the Supreme Court had before it a case, arising in a state court, of a bond given to release an attachment. Pending this suit, the principal was adjudged bankrupt and then received his discharge. Thereafter the attaching plaintiff won his suit and the state court, agreeably to its practice, entered judgment against both the principal and the sureties on the bond. The Supreme Court held that the judgment should be perpetually stayed as to the principal, but not as to the sureties, saying that "they were bound not to pay any judgment which might be rendered against him, but to pay the debt he had agreed to pay in a certain event, which had happened."⁴⁷ Some of our state courts have reached the same result, under both the Act of 1867 and the present law.⁴⁸ In other jurisdictions a contrary result was reached under the older statute, and also under the present Bankruptcy Act.⁴⁹ In Connecticut a distinction has been drawn between a "forth-

⁴⁴ *Schunack v. Art Metal Co.*, *supra* note 23; *U. S. Engine Co. v. North Penn. Co.*, *supra* note 23.

⁴⁵ *Southcote v. Braithwaite* (1787, K. B.) 1 T. R. 624; *Hall v. Fowler* (1844, N. Y.) 6 Hill, 630; *Knapp v. Anderson* (1877) 71 N. Y. 466.

⁴⁶ *Odell v. Wootten* (1868) 38 Ga. 224. ⁴⁷ *Wolf v. Stix* (1878) 99 U. S. 1, 9.

⁴⁸ *Macombs v. Allen* (1880) 82 N. Y. 114; *King v. Block Amusement Co.* (1908) 126 App. Div. 48, 111 N. Y. Supp. 102, *aff'd.* (1908) 193 N. Y. 608, 86 N. E. 1126; *In re Federal Biscuit Co.* (1914, C. C. A. 2d) 214 Fed. 221; *Schunack v. Art Metal Co.*, *U. S. Engine v. North Penn. Co.*, and *Butterick Pub. Co. v. Bowen Co.*, *supra* note 23.

⁴⁹ *Crook Horner Co. v. Gilpin* (1910) 112 Md. 1, 75 Atl. 1049; *Windisch, & Co. v. Simms* (1911) 129 La. 134, 55 So. 739; *Klipstein v. Allen-Miles Co.* (1905,

coming" bond, which merely substitutes itself for the property attached, but leaves the attachment in legal effect, and a bond which is intended to be taken in lieu of the attachment. In the latter case, the court says,⁵⁰ "the attachment is regarded as not only non-existent, after the adjudication in bankruptcy, but as being an event of the past possessing no manner of significance in the present." But in the case of a forthcoming bond there is "such a relation between the bond and the attachment by virtue of the office of the former under the statute, and of its compulsory substitution for the attachment by the operation of the machinery of the law, set in motion as a statutory incident of the attachment, as to entitle the bond to be regarded in the eye of the law as dependent for its life and efficiency upon the continuance of the attachment."

The cause of this conflict of opinion is quite apparent. The effort of the courts was to fit together ideas which had originated in alien sources. The courts had to consider several things in their relation to each other; the subjects presented including the nature of a judgment, and the bearing thereon of bankruptcy, and these things together as defining the meaning of the bond which had been given. Let us now attempt the same task.

Obviously the first question is, how does bankruptcy affect a judgment? Fundamentally the court takes the debtor's estate as he left it, and subject to all outstanding liens, except such as constituted the means of working a fraudulent or a preferential transfer. But, once the bankruptcy court took an estate into its custody, the statutes always forbade the obtaining of further liens. It followed that, if a judgment was obtained prior to the bankruptcy, it was good as a lien on real estate wherever state laws so provided; if an execution had been levied the plaintiff could proceed to judgment and sale; and if an attachment had been procured the creditor could proceed to judgment, being limited, however, to a realization only out of the attached property.⁵¹ But beyond that the judgment, levy, or attachment had no effect. As to any deficiency, between the amount realized out of the property thus specifically taken in charge prior to the bankruptcy and the total amount of the debt, the creditor was simply a general creditor, his judgment being useful only as proof of his debt.⁵² Such was the general effect of

C. C. A. 5th) 136 Fed. 385; *Carpenter v. Turrell* (1868) 100 Mass. 450. The same result was reached in Michigan, where the bond was to discharge a *capias*. *Bryant v. Kinyon* (1901) 127 Mich. 152, 86 N. W. 531.

⁵⁰ *Schunack v. Art Metal Co.* (1911) 84 Conn. 331, 336, 80 Atl. 290, 293.

⁵¹ *Peck v. Jenness* (1849, U. S.) 7 How. 612; *Doe v. Childress* (1874, U. S.) 21 Wall. 642; *Butterick Pub. Co. v. Bowen Co.*, *supra* note 23; *Oldfield's Syndicate v. Am. Imp. Co.* (1919, C. C. A. 9th) 260 Fed. 905; see also *Hill v. Harding*, *supra* note 27, *Wolf v. Stix*, *supra* note 47.

⁵² See *Barry v. N. Y. Holding Co.*, *supra* note 21; *Oldfield Syndicate v. Am. Imp. Co.* *supra* note 51.

the bankruptcy laws of former times. With the progress of legislation, however, complications have arisen. The National Act of 1867 (sec. 14) invalidated all attachments and levies obtained during the period intervening between the filing of the bankruptcy petition and the adjudication. By a much more extensive *ex post facto* process the present National Bankrupt Act (sec. 67) invalidates "all levies, judgments, attachments, or other liens obtained through judicial proceedings" against the bankrupt "at any time within four months prior to the filing of a petition in bankruptcy against him." It is true that there is a proviso in favor of a bona fide purchaser at an execution sale held prior to the bankruptcy. But that does not avail the judgment creditor or attaching creditor, as the case may be, because, while the trustee cannot get back the property from the purchaser, he is entitled to claim the proceeds of sale if still in the sheriff's hands⁵³ or if too late for that, to recover it from the judgment creditor in an action for money had and received.⁵⁴

The play of this legislation, upon the court bonds in which we are interested, may easily be seen if we ascertain what the obligee of any such bond really desired. The answer is easy; what he wanted was a judgment. But a judgment is of a double nature. First is its aspect of *res judicata*; it determines whether anything is due, and how much. Second, it gives the creditor the right to realize his debt out of the debtor's property. The attachment fits in with this latter aspect of the judgment by taking into custody meanwhile the attached assets, so that out of them at least the creditor will have a prior right of realization when he gets his judgment. And it is quite obvious that the judgment is desired, not as *res judicata*, but as a means of realizing the debt. It is inconceivable, indeed, that a creditor should seek a judgment which should not carry with it the power of realization. For this power, in the words of the Supreme Court, is "a part, and an essential part, of every judgment passed by a court exercising judicial power. It is no judgment, in the legal sense of the term, without it."⁵⁵

This, it is submitted, gives the answer to the problem on which the courts have so radically differed. The surety underwrites a bond which is intended in the words of the Massachusetts court, to be the equivalent of "a judgment valid against the principal and which he is bound to pay"⁵⁶ If, because of the intervention of bankruptcy and his

⁵³ *Clarke v. Larremore* (1903) 188 U. S. 486, 23 Sup. Ct. 363.

⁵⁴ *In re Weitzel* (1911, E. D. N. Y.) 191 Fed. 463; *Dreyer v. Kicklighter* (1916, S. D. Ga.) 228 Fed. 744; *In re Breslauer* (1903, N. D. N. Y.) 121 Fed. 910.

⁵⁵ *South Dakota v. North Carolina* (1904) 192 U. S. 286, 24 Sup. Ct. 269. The creditor's "common natural right is to collect his debt by subjecting his debtor to due process of law in any jurisdiction where he may find him." *Netograph Mfg. Co. v. Scrugham* (1910) 197 N. Y. 377, 380, 90 N. E. 962, 963.

⁵⁶ *Carpenter v. Turrell*, *supra*, note 49, at p. 453.

discharge, the principal is not "bound to pay" the judgment, then the bond should not be considered effective. The question in each case should be whether the bankruptcy has left the judgment, or the attachment as the case may be, valid as a subsisting lien on anything at all. If so, then the bond should be made to respond, but otherwise not. For, when the effect of bankruptcy in the particular case is to deprive the judgment or attachment of any capacity of lien or levy, then in principle the case would seem no different from that of a bond given in discharge of an attachment issued against the property of a defendant who is by statute exempt from the writ. Such a bond is not actionable, because "there was no lawful attachment and therefore no lawful authority for taking any bond whatever"⁵⁷ Bankruptcy, when it does destroy the lien of a judgment or attachment, operates in exactly the same way; the lien is destroyed by statute, and there would seem to be no difference between destroying a lien *ex post facto* and forbidding its creation at the outset.

Whatever may be one's thought on this particular topic, however, no conclusive answer can be expected from judicial sources, conclusive, that is, in the sense of settling the law for all parts of this country. There can be no such answer because the question is not "federal,"—unless the courts should change their minds in this regard,—and therefore the views even of the Supreme Court are but persuasive so far as state courts may be concerned.⁵⁸

But it does not matter much. Our law would lose half of its charm if it did not have its open questions, and for the student the task is not so much to answer a question as to realize how it has arisen. Any such endeavor will justify itself if in the course of it should come renewed appreciation of the nature of our law as an organic whole, and not as a collection of separate subjects of thought. The composition has artistic effect, but nevertheless it is a composition.

⁵⁷ *Pac. Bank v. Mixer* (1888) 124 U. S. 721, 729, 8 Sup. Ct. 718, 722 (attachment against property of a national bank).

⁵⁸ *In re Federal Biscuit Co.* (1914, C. C. A. 2d) 214 Fed. 221; *In re Mercedes Import Co.* (1908, C. C. A. 2d) 166 Fed. 427; *In re Rosenthal* (1901, S. D. N. Y.) 108 Fed. 368; *In re Maaget* (1909, S. D. N. Y.) 173 Fed. 232; *In re Squier* (1908, E. D. N. Y.) 165 Fed. 515. *Wolf v. Stix*, *supra* note 47, and *Klipstein v. Allen-Miles Co.*, *supra* note 49, must be taken in that light. The court's jurisdiction in the latter case was based on diversity of citizenship; and in *Wolf v. Stix* the Supreme Court's jurisdiction to review the state court's judgment was based on quite a different federal question. See *supra* note 21.